part to encourage sound education and the cultivation of good taste; and, having done this, we neither need nor can do more for the behoof of our mother-tongue. As to our forefathers, let us rest with endeavouring to emulate their virtues. Their speech was part of an organic whole, and harmonized with all its accompaniments. And our speech is part of another, and a very different, organic whole, which we shall only mar by discord, if we affect the diction of antiquity. And, while we would dissuade from trying to call back that which was fated to perish, we would also dissuade from solicitude to improve on that which, in the estimation of the most competent judges, asks for no present amendment. Neither from studious retrogressionists nor from studious innovators can we hope for a stamp of English superior to what we now possess. Consideration being waived of those exceptions for which it is the province of thorough scholarship to legislate, then only does a language, circumstanced like ours, develop healthily, when, silently controlled by the liberal culture of influential writers and speakers, it develops all but insensibly.

FITZEDWARD HALL.

ART. IV. — *Lombard Street. A Description of the Money Market.* By WALTER BAGEHOT. New York: Scribner, Armstrong, & Co. 1874.

MR. BAGEHOT'S work upon "Lombard Street," in its interest for the American public, bears to that on the "English Constitution" the relation of the special to the general. Undoubtedly it is of chief importance that the spirit of criticism and amendment, in our institutions of less than a century, should proceed upon a careful study of that other frame of government upon which they were substantially based, and which alone among modern nations has borne the germs of popular freedom in continuous and more or less steady development for upwards of five hundred years. But there is a pressing and immediate necessity that we should arrive at some settled

and sound principles upon the subject of currency, and still more upon that of banking. It is a bold man, however, who, valuing his reputation for common-sense, undertakes in this country and at this time to write upon these topics. Any one who has passed into Boston over the Brighton Road and the Mill Dam, in one of our northeasterly storms, will have noticed that, through the steady pressure of the wind and the rain, there come at intervals furious gusts, in which both seem to beat with unusual violence. In like manner, while there is a steady stream of financial writing in newspapers and periodicals, any marked event, like a financial pressure, a sudden rise in gold, failures among the national banks, will produce a tempest of theories, before which the public, buffeted and breathless, takes refuge in contempt and despair. And the phenomena, in both cases, are about equally barren of result. As Mr. Bagehot says, after ten years of such discussion, we have not begun to arrive at the nature of the problem with which we have to deal. Our financial writers are like the spirits in the second circle of Dante's *Inferno*, condemned to be beaten about incessantly by contrary winds: —

> "Cosi quel fiato gli spiriti mali,
> Di quà, di là, di giù, di sù, gli mena
> Nulla speranza gli conforta mai,
> Non che di posa, ma di minor pena."

Still, when so high an authority undertakes an analysis of English banking, it may be a shade less unprofitable to exemine his conclusions in the light of our own experience.

Mr. Bagehot begins by declining altogether to discuss the Bank Act of 1844, on the ground that that Act forms such a bone of contention between the two parties in favor of and hostile to it, that his readers would judge his book at once from the partisan point of view. There are two reasons which justify this attitude of Mr. Bagehot, and yet render some reflections upon this Act of great importance to us. In the first place, we know from his other writings that he is, upon the whole, favorable to the Act, and as it is for the present firmly established, and there are no signs of any intention on the part of the leaders of either of the great parties to depart from it, there is no need of any defence of it in his

book. Secondly, there is throughout the book, as it seems to us, and as we shall presently explain, a misconception as to the true nature of bank deposits, — a misconception upon which are based nearly all the arguments against the Act of 1844, advanced by parties who are hostile to it.

The prime object of the Act of 1844 was to secure the absolute convertibility into specie, at all times, of the note circulation of the country. As there is, financially speaking, hardly any consummation more desirable for the United States, we shall devote a short space to the consideration of the principles on which the Act is based and the results obtained. The necessity of contraction to remedy a disordered currency, first insisted on by the Bullion Committee of 1810, was assumed as a starting-point. One can hardly suppress a sigh in thinking how this elementary principle, this A, B, C of currency, is being fought over in this country. Another assumption, for which there is the high authority of Lord Overstone quoting Hon. Daniel Webster, was this: that a currency convertible into specie may be greatly inflated, the inflation manifesting itself only at a subsequent period. By parity of argument, the premium on gold at any one time may not show the actual depreciation of an inconvertible currency, — a fact which we believe this country has yet to learn by sharp experience. Assuming, then, that an inflated currency, even though convertible, creates unfavorable trade, and thus tends to lay the foundation of an excessive demand for specie export, the object was to detect this tendency at the earliest possible moment, and to check it by contraction of the currency. This end would be attained if every pound sterling of gold exported, beyond a certain limit, caused the annihilation of a corresponding amount of currency. To effect this, however, it was necessary that currency should be entirely separate from banking, because otherwise gold might be drawn out by depositors and exported, without any reduction of the note currency or consequent contraction. If, after thus separating currency from banking, the whole circulation was based upon specie, that is, if no note was issued without a corresponding quantity of gold behind it, it is perfectly obvious that a suspension of specie payments would be physically impossible. But it was

held that this extreme theoretical perfection was not necessary. There was a point beyond which contraction could not be carried without so greatly depressing prices as to bring gold from all parts of the world. A certain amount of the currency must therefore remain out under all circumstances. It could never be all presented. And if it could be ascertained what amount was certain so to remain out, it would be perfectly safe to issue that amount against permanent securities, as bonds, mortgages, and the like. In the actual case under consideration, all banks having the right to issue notes were to take the amount outstanding on a certain day as the maximum which they were never to exceed. In addition to this the Issue Department of the Bank of England was to issue £14,000,000 of notes (making about £33,000,000 to £34,000,000 in all) against government securities. Beyond this amount it might issue notes to any extent against gold, and only against gold actually in hand. The result has been that never during thirty years since the Act was passed has there been the slightest doubt as to the redemption of the note. During three severe financial crises, involving the suspension of the Act for reasons which we shall presently touch upon, and when the rate of discount was as high as ten per cent, the Issue Department has never held less than one third of its outstanding notes in gold, which was entirely at the disposal of any one who could present its notes. The objections to the Act as far as the circulation is concerned have been only two: first, that while the business of the country has more than quadrupled, and therefore requires greater facilities, the amount of the note circulation has remained nearly stationary. To this it has been replied, as it seems to us most conclusively, that notes can be had to unlimited amount in exchange for gold, and that, if they have not increased, it is simply because the trade of the country has not brought in the requisite amount of gold. The second objection is against keeping so large an amount of gold (on the average £20,000,000, or $100,000,000) unproductively on hand. But the cost of doing this is exactly measured by the interest on the sum. If an amount of £10,000,000 were added to the issues on fixed securities, the annual saving at three per cent would be

£300,000, or $1,500,000. Probably this might be done with entire safety, but the sum is a small one for the nation to pay for the insurance of that priceless blessing, a currency convertible beyond the possibility of question.

The other objections to the Act will be treated of when we come to banking; but with these exceptions, and as far as the circulation is concerned, we believe the bitterest enemy of that Act will not question its successful working, or the demonstration of the principles on which it was based. And however little Mr. Bagehot may think it worth while to undertake a defence of it, the importance of a thorough understanding of it in this country can hardly be overestimated. All of the thousand and one schemes for resuming specie payments, which are either in earnest or worth attention, involve contraction; one half of them being directed to depriving this process of its sting, and the other half to committing the country to go through with it, however severe that sting may be. But few or none of them include in their calculations the object to be obtained by contraction. Bringing gold to par is by no means equivalent to specie payments; and if we were to come to specie payments, that does not at all imply their continuance for six months or six years to come; and again, upon the adjustment of the currency it depends whether by a mininum of contraction and consequent suffering we shall arrive at a permanent and stable system of specie redemption, or whether by a tremendous crisis and almost universal bankruptcy we shall force gold down to par, to see it again bound upwards after an interval of a few months. Believing as we do that contraction is a stern necessity, and the evils of it in no wise to be avoided, we also believe that the first step is to digest thoroughly the system upon which we propose to do business in future: just as to a man about to jump out of a fourth-story window, we should commend the previous careful disposition of a feather-bed on the sidewalk below. In the present confusion of the greenbacks and the national bank-note system, adequate contraction would be wanton and superfluous cruelty. The Suffolk Bank system, which answered fairly well for New England, would be an impossibility for the whole country. But that system was a step in the right direction. It provided for

redemption by one bank. If it had also included issue by one bank, and confined that bank to the business of issue alone, we should be much nearer the solution of the problem. The objection to a monopoly of profit would be met by a bargain on the part of the Treasury which would leave to the issuing bank just sufficient compensation for doing the business, and retain the profit where it belongs, for the nation at large.

A recurrence to our opening reflections warns us to quit speculation and to stick to our text. We have stated that throughout Mr. Bagehot's book there seems to us to be a misconception as to the true nature of bank deposits; and as upon it the whole discussion will turn, it is important that this should be clearly explained and established. Not only Mr. Bagehot, but every other English writer with whom we are acquainted, treats bank deposits as the actual savings of the community, left for security and convenience with the class of persons called bankers, who make use of them in loans to their customers, and points to the vast increase of these deposits as evidence of the accumulation of wealth in the last thirty years. On the other hand, nearly all writers upon the subject in this country take the ground which will be assented to by almost any bank cashier of intelligence, that these deposits are in fact creations of currency by the banks in exactly the same sense and with the same effect as their note issues. The importance of the consequences which follow upon these different theories renders it necessary that we should enter upon a succinct analysis of the nature and operations of a bank.

Let us suppose such an institution to commence with a capital of \$100,000 paid up in specie, and with \$50,000 in notes or bills prepared for issue. The national banks are the same in principle, though they get their circulation by first investing their capital in government bonds. Of the numerous bills offered for discount the bank accepts say \$100,000, and pays out its notes and half its gold. These, after passing through various hands, form the receipts of a large wholesale dealer, who sends them to the bank to be kept for him. The bank gives him a little book, called a pass-book, with the amount entered on it which he is entitled to receive when called for. But supposing he does not call for it, the bank may proceed to

lend again the $50,000 of gold and notes by granting a discount to somebody else. Next we will suppose that a large mercantile firm wish for $50,000 for a time, and give their notes to be discounted. They do not wish for either gold or notes, but that the amount shall be placed at their credit, to be drawn as wanted. They in like manner receive a pass-book with the amount $50,000 entered at their credit. The bank accounts will now stand, exclusive of interest:—

Assets.

Notes discounted, payable in the future, ...	$ 200,000
Gold in reserve, ...	50,000
	$ 250,000

Liabilities.

Capital stock (belonging to stockholders, a claim on the gold or notes discounted), ...	$ 100,000
Notes payable in gold on demand, ...	50,000
Deposits " " or notes, ...	100,000
	$ 250,000

If a depositor has occasion to pay any money, he gives to a third party a check or order on the bank for a certain sum. If it is a small amount, the payee may draw out notes or gold; but, if a large one, he probably makes a deposit in the bank on his own account, and the sum is credited to him and charged to the drawer of the check; in other words, it is transferred from one account to another, and may go on being so transferred until some person who has a note to pay at the bank sells his property for a check on the bank. This check pays his note, and, being charged to some depositor, *cancels* that amount of deposits.

When there are two or more banks, the statement is somewhat more complicated, but the result is precisely the same. The purpose of the clearing-houses of New York and Boston is to exchange the checks and bills of the different banks among themselves, but the effect is to make them practically one great bank. It consolidates their deposits into one great mass, and makes transfers from one account to another as a single bank would do. To illustrate this compare the sup-

posed account of one bank, which has been given, with the clearing-house returns of all the New York banks for the week ending December 29, 1860, before the suspension of specie payments: —

Assets.

Notes discounted and loans, ...	$ 131,316,258
Specie, ...	23,275,058
The balance not included in the returns consists of items of property such as real estate, fixtures, etc.,	10,620,637
	$ 165,211,953

Liabilities.

Capital stock, ...	$ 69,758,777
Circulating notes, ...	8,287,582
Deposits, ...	87,165,594
	$ 165,211,953

The item of deposits goes along with only a small percentage of change from day to day, from week to week, and from month to month, notwithstanding that the exchanges at the clearing-house may vary by tens of millions daily.

The theory of these deposits which we wish to establish rests upon three propositions. *First.* They are money, and while they exist are the exact equivalent of notes and gold. *Second.* They are money created by the banks, and just as much an addition to the circulation as if the banks issued so many additional notes. *Third.* They are money created to an indefinite extent by means of promises to pay on time, and cancelled by payment of those promises.

First. Deposits are money. If you wish to pay a debt, or make a purchase, and you offer gold coin, bank-notes, or a good check, the two latter being, of course, redeemable in specie, would the recipient have any choice; or would he not prefer the check as a matter of convenience? It is important to remark that the check is not the money. The money is the deposit in bank, which may be transferred by check any number of times, and still remain the same sum. And these three things are the only ones which strictly fulfil the definition of money; that is, what one man takes from another, which a third will take from him, without any question of price. If

you wish to buy a piece of land, and offer barrels of flour in payment, the price of both must first be determined; but if you offer money, the question of price refers to the land alone. And here is a sharp distinction between money and promises on time. The latter, whether in the form of a note at sixty days, or of a government bond at twenty years, involve a question of interest, and, therefore, of price. They may, and do, form a basis for the issue of note and deposit money, but they are not money themselves; a distinction, which, if generally understood, would help to clear away the popular confusion between the condition of our currency and that of our funded debt.

Second. Deposits are money created by the banks, and are precisely the same in effect as an additional issue of notes. We will recur to our first statement of account. Our bank started with $100,000 capital in gold, and $50,000 in notes. Now, there are but two ways of putting money in circulation, — either by buying something, or by making loans. In the first case it is an investment, and the buyer takes the chance of getting more or less than he gave when he wants his money. But in the case of a loan, the repayment brings the money back and takes it out of circulation. As we have seen, the bank has by means of loans put $50,000 of its gold and its $50,000 notes in circulation; and it has also put in circulation $100,000 of deposits by precisely the same method, the difference between writing the amount on a pass-book or on pieces of paper of different denominations being merely one of form.

Again, the bank owes $50,000 in notes and $100,000 in deposits, the claim of which upon its $50,000 gold reserve is precisely the same. For meeting these liabilities it relies upon the future payment of $150,000 of commercial bills which it has discounted with cash. But this cash consisted partly of its own notes and partly of its book credits or deposits; the choice between the two being left to the person applying for discount, as they are identically the same to the bank.

Third. Deposits are money, created to an indefinite extent by means of promises to pay in the future, and are cancelled

by the payment of these promises. The advocates of free banking say that it is nonsense to talk about excessive issues, because if any bank should issue more notes than are wanted, they would be returned at once for redemption. Suppose two banks, A and B, have each granted a discount for $50,000, and given their notes in payment. A's customer pays away his notes to a party who deposits in bank B, and B's customer pays his to a party who deposits in bank A. The two banks exchange notes with each other, and the notes are redeemed, and may be cancelled or reissued. But in either case there remain deposits of $50,000 in each bank, payable to their customers on demand. Take even a simpler case; a single bank has given its notes in payment for a discount, and the recipient pays them to a party who returns them at once to the bank. But unless he draws gold for them, which he will not unless for export, or from distrust of the bank, he leaves them on deposit, and the latter remains a fund at his disposal. The fact is, that the deposit *cannot* be cancelled, unless by payment of the note discounted, or the withdrawal of gold. And as interest has been paid for the cashing of the note, it probably will not be paid till maturity.

Another class of the advocates of free banking maintain that, as notes on time are created by the sale of commodities, no more such notes can be created than the demand for commodities will produce. The assumption on which this assertion is based is in one sense untrue, and in another is of no force whatever. There is no doubt that accommodation notes, made for the express purpose of raising money, form a large part of the bank discounts. But suppose A has a commodity which B will buy on time, hoping to sell it before his note matures. A gets B's note discounted at a bank, and has a deposit at his credit. In a few days C offers B a profit on the merchandise, if he will take his note on time. B gets C's note discounted, and has another deposit at *his* credit. And so the same property may pass through a dozen hands, each time creating a note and the means of adding its whole amount to the deposit currency. Of course, the banks wish to draw interest on as many notes as possible; and as, with the increase of money, whether by deposits or notes, prices advance,

their customers become more and more willing to gain the benefit of a rise in prices by undertaking payment in the future; and the same rise in prices gives an increased rapidity of circulation, which has again the effect of increasing the apparent amount of money.

With this common disposition of the banks and the public there is in itself no limit to the extent to which this discount and deposit may be carried. If the banks are required by law to hold a certain proportion of specie to their liabilities, they must refuse discounts after the proportion has been reached; or if again, by the increase of money, prices are raised and foreign imports are stimulated, until their specie reserves are drawn out for export, they may not only be forced to refuse any increase of discounts, but to contract their deposits by demanding payment of loans, and thus bring on a financial panic.

The deposits of the London joint-stock banks, exclusive of the Bank of England, were, in 1844, £10,000,000; in 1861, £51,000,000; in 1866, £82,000,000; in 1873, £93,000,000: and in July, 1874, £97,000,000; an increase of more than ninefold; the deposits of the Bank of England having in the same time increased from £13,000,000 to £27,000,000. And there is reason to believe that the expansion over the whole of Great Britain has advanced, if not in equal, in something like as great, proportion. In view of these figures, the importance can be hardly overrated of deciding between these two theories of deposits, whether they are actual creations of currency, or the accumulated hoards of private savings. Not only is the latter view the one taken by Mr. Bagehot and other English economists, but, so far as we are informed, there is no English writer to whom the possibility of the other explanation seems to have presented itself.* Lord Overstone, in his evidence before the Parliamentary Committee of 1840, denies that deposits are money, but he classes them with checks and bills of exchange (which we hold to be of a quite different nature), making his argument against the latter cover the former also.

* In the January number of the Fortnightly Review is an interesting article by Mr. R. H. I. Palgrave upon Mr. Bagehot's book, reviewing and warmly commending it; but there nowhere appears a trace of a suspicion that deposits are anything but private savings left in care of the banks.

Assuming, for the sake of argument, the correctness of what may be called, for the purpose of distinction, the American theory of deposits, we will consider some of the consequences which flow from it. In the first place, it furnishes, as we have already indicated, a cogent answer to the principal objections against the Act of 1844. The complaint that, notwithstanding the immense increase of business, the note issues of the Bank of England are not materially larger than thirty years ago, is found to be of no force, if we consider that the London joint-stock banks alone have furnished an increase of exactly equivalent currency to the amount of six times the issues upon fixed securities. It is bitterly complained that the Act has not served to prevent the violence or the frequency of financial panics or the corresponding fluctuations in the rate of interest. But besides that, as Lord Overstone has pointed out, the Act of 1844 could not be expected to prevent panics, which would take place even with a currency all metallic, it is evident that this immense superstructure of deposit currency has greatly increased the liability to such panics. In fact, it can hardly be doubted that, without the greatly increased stability given by the Act, this vast fabric of deposit banking could not have been created without involving suspensions of specie payments of more or less permanence.

The three suspensions of the Bank Act in 1847, 1857, and 1866 have caused many sneers at a system which is expected to give way whenever a storm comes on. But, as already stated, these suspensions had nothing whatever to do with the convertibility of the currency. The Issue Department has never at its lowest point held less than a third of its outstanding notes in gold subject to presentation. The demand was not for gold, but notes. The bank reserve of the latter is so small at all times, that any extra drain, whether domestic or foreign, brings on a panic, not as to the convertibility of the notes, but as to the solvency of the banks. It is very noteworthy that the panic in this country last fall was of the same kind. There was no trouble about notes, either greenback or national bank. A panic is a fear lest debtors cannot get the means of paying their debts. But the notes are a legal tender, and a holder of them runs no risk in this respect. If a panic as to the notes

ever takes place, it will find expression in the price of gold. In the existing case the reserves of the banks had run so low that depositors became alarmed as to the possibility of getting notes. Without the issue of what is absurdly called the "reserve" of forty-four millions, the panic would have gone much further than it did, and with that issue and any given amount additional it must break out again at a future day. What, then, is the difficulty with this vast machinery of banking which, standing on so different a footing in Great Britain and this country, and being based on a currency convertible there but inconvertible here, yet results in disasters almost exactly similar in their nature?

Two fundamental ideas run through the whole of Mr. Bagehot's book, of which the first is this: that it is wrong, unjust, and dangerous that the whole banking reserve of the kingdom should be kept in one bank, the Banking Department of the Bank of England. He points out in detail how all the country banks of Great Britain keep their cash resources in some one of the London banks, and how all of these London banks keep *their* cash resources with the Bank of England, so that the reserve of notes in this one institution constitutes the fund which must meet a sudden demand from all parts of the kingdom. This position will be made clearer to us if we suppose all the national banks of the United States to keep their whole cash resources in the New York banks, and these banks to keep all their resources in one bank, say the Bank of Commerce, the latter being required to hold only the regular 25 per cent, or, as a fairer supposition, from 30 to 40 per cent of its own liabilities as reserve. It is not difficult to imagine the consequences of such a state of things here.

Mr. Bagehot makes a comparison of the banking reserves of Great Britain, France, Germany, and the United States, of which the first and last, being chiefly of importance to us, are as follows:—

English liabilities, including the deposits in the Bank of England and the London joint-stock banks, December 31, 1872, ...	£120,000,000
Banking reserve in Bank of England, . .	13,500,000

Percentage of reserve about 11.2 per cent.

National banks of United States, October 3, 1872 : —

Circulation, ...	£ 67,000,000
Deposits, ...	145,000,000
	£ 212,000,000
Coin and legal tenders in hand, ...	26,000,000

Percentage of reserve about 12.3 per cent.

But this comparison, as Mr. Bagehot himself points out, is defective as including only the figures for the London banks. Mr. R. H. I. Palgrave, in a paper read before the British Association at Bradford, England, and commended by the *Economist* (Mr. Bagehot's paper) as entitled to a high degree of credit, estimates the deposits of all the English banks at £500,000,000, which would give in the above comparison the cash reserve of the Bank of England at a percentage of 2.7 per cent against 12.3 per cent for the national banks of the United States. That the English system, therefore, can carry deposits of twenty-five hundred millions of dollars upon a reserve of less than three per cent, while ours is severely strained with deposits of seven hundred millions of dollars upon a reserve of 12.3 per cent, and that too in a basis of inconvertible currency which cannot be exported, points to a steadying influence of some kind in the former of greatly superior power.

While admitting, however, the grave defects of the one reserve system as practised in England, Mr. Bagehot frankly states that it is useless to hope for or advocate any change. He treats the adoption of a many reserve system as wholly impracticable, dismissing the American system, in which it is required, with a single contemptuous allusion in the last page of his book, and confining himself to the consideration of what should be the proper management of the single reserve in the Bank of England. From this conclusion we wholly dissent, nor do we believe that it will pass much longer in England without serious challenge. Even if all the deposits of the Bank of England were kept in a reserve of notes, the amount would be scarcely five per cent upon the deposits of the country, — a proportion quite inadequate to the effective treatment of those alternations of inflation and panic which are seriously affecting the commer-

cial supremacy as well as the social condition of Great Britain. Again, even if we consider the deposits as the accumulation of individual savings held by the banks, there is no reason why, for the sake of making profits of fifteen to twenty per cent, those institutions should be allowed to loan their resources so closely as to make them in fact grand machines for the aggravation of panics. But the case is infinitely worse if we regard these deposits as actual creations of currency, exactly the same in effect as issues of notes. It is simply monstrous that less than a dozen private corporations should have the power of inflating the currency to the extent of five hundred millions of dollars, without any obligation to hold a steadying balance of cash, and then, when this course of proceeding comes to its natural result of a crisis and a panic, should exert all their powerful machinery to take care of themselves, regardless of the consequences in the social, moral, and commercial character of the people. For it is to be observed that it is by no means a simple question of the solvency of the banks. It is the fashion in England, to which we regret to see that Mr. Bagehot, perhaps upon compulsion as the editor of the *Economist*, conforms, to point to these joint-stock banks as marvels of success and good management, as if the public were only concerned with them as shining examples. The fact is, that these banks, by their immense creations of deposit currency, compel the country to do its business with the very smallest possible amount of gold and notes issued against gold. When this inflation of currency brings on an adverse foreign trade, according to well-known principles, a comparatively small drain of gold creates a scarcity of notes. The joint-stock banks do not burden themselves with any stock of notes, at a loss of interest, to relieve this scarcity. Beyond a moderate deposit in the Bank of England, they keep (and they plume themselves greatly upon their discretion and conservatism in so doing) a large loan at call upon the best collaterals, and a further amount of consols, the most marketable of all securities. Armed with these weapons, they descend upon the money market upon the first appearance of a panic, and bear off in triumph to their vaults the small remaining supply of notes upon which the trading community rely to meet their own obligations, thus immensely

aggravating the crisis which they have themselves been mainly instrumental in bringing on. The Manchester warehouseman, who is forced into insolvency by a sudden clearing out of the Bank of England reserve, must, if he understands it, contemplate with admiration the brilliant success of London joint-stock banking. We believe that any successful attempt to deal with panics, to avoid chronic suspensions of the Act of 1844, and to arrive at the real working of that Act, will be to require every English joint-stock bank, and especially the London banks, to keep on hand a certain percentage of notes to liabilities as a reserve. Upon the American theory of deposits, there can be no question as to the justice of this. And this theory carries another consequence. A reserve in the London banks of twenty per cent upon their deposits of £ 90,000,000 would give £ 18,000,000, which, added to the present issues of the Issue Department, would make about £54,000,000, of which £ 15,000,000 would be issued against fixed securities and £ 39,000,000 against gold. If it were found to be safe to hold £ 19,000,000 of gold and to increase the issues to £35,000,000, the gain to the nation at three per cent would be £ 600,000 per annum, contributed by the London banks as a consideration for the valuable privilege of creating currency in the form of deposits for their own private profit.

What makes all this of practical interest to us is the curious parallel offered by our own case. The New York banks are obliged by law to hold twenty-five per cent reserve against their liabilities of notes and deposits, though it is almost comical that they are allowed to include in this their specie, which, for all its use *in this respect*, might as well be an equivalent value in pig-iron or potatoes. The banks have been very fretful under this restriction, and up to the summer of 1873 there was a great deal of argument used to show that they ought to be released from it, though since the panic of last autumn we have heard no further mention of the subject in public.* On the

* The release of the required reserve against note circulation (except the five per cent deposited with the Treasury), which passed Congress with the usual absence of effective discussion, will probably display its effects in the next panic, not in distrust of bank-notes, which in their accumulated security, including the government guaranty, are quite as desirable as greenbacks, but in that of bank deposits, the convertibility of which is greatly weakened by this diminution of the legal reserve.

24th of September, 1873, their returns showed thirty-four millions of legal-tenders, which are reported to have been soon after reduced to five or six millions. Now, it was exactly the power of enduring such reduction that saved the banks from disaster compared with which what did happen was as the ripple of a summer breeze upon a mill-pond. The London banks are a standing proof that banks which are not compelled by law to hold a cash reserve will not hold any. There is here no Bank of England to carry the burden which properly belongs to others. If the New York banks had been under no restriction as to reserve, the crisis might have been postponed for a year or two, but it would have then come in a shape which would have left but few traces of many of those institutions which have basked in the sunshine of the last eight years.

The reserve required by law under our national-bank system seems to be sufficient in amount, but very badly managed. On the other hand, though the reserve in the Bank of England is quite inadequate in amount, the evil consequences of this are largely obviated by skilful management. And this brings us to the second of the fundamental ideas in Mr. Bagehot's book referring to the principles upon which the management of bank reserves should be conducted. At first sight it would appear to be the true policy of the reserve-holding bank (or banks) to strengthen itself in a time of panic as much as possible; to allow its discounted bills to mature; to refuse fresh loans, and to gather in as many notes as possible for the purpose of meeting demands. But nothing can be further from the truth. Both duty and sound policy require the utmost liberality in such times, and not more than ordinary scrutiny as to security. And the reason of this is very simple. The depositors and the public are always stronger than the banks. No amount of reserve consistent with profit in banking can resist a really serious run. The only hope is in the forbearance of the public. If the impression gets abroad that all loans are soon to be refused, it will bring an immediate rush from all quarters for money. Only the confidence that money can be had when needed will keep back the crowd of claimants who do not really need it. As Mr. Bagehot forcibly remarks, the reserve *may* be exhausted if the bank continues

to discount; if the bank refuses to discount, it is certain to be. It may be asked, however, What proof is there that continued loans will allay panic? Is the bank to go on recklessly, without paying any attention to its reserve, except to increase its liabilities as the latter diminishes? Under the English system, which we are now considering, there are two safeguards: one local and peculiar, and the other of general application. The ultimate one is doubtless the suspension of the Act of 1844. The public are persuaded that the government will not allow the Bank of England to fail, and are therefore very impatient of any restrictive policy in the latter. In 1857, it is said that the Bank, not wishing to rely upon the suspension of the Act, undertook to refuse discounts, but that several large depositors combined to notify the Bank of their intention, if it persisted in this course, to join in drawing out their balances and compelling the Bank to close its doors. The other resource includes the most valuable practical lesson for this country to be found in Mr. Bagehot's book. It is a rise in the rate of interest upon loans, — a rise which should commence when the reserve begins to fall below the average point, should be continued sharply while the reserve continues to decline, and be relaxed only when the reserve again accumulates toward the normal point. Now, as the English method is to lend freely in time of panic with an unlimited advance in the rate of interest; and as the American law prohibits all loans after the reserve falls to the prescribed point, and limits the banks to the rates of interest prescribed by the usury laws of the several States, it is obviously important to discover which of these diametrically opposite courses is correct in practice. The question of continuous loaning was, as has been said, practically settled last fall. The New York banks continued, in defiance of the law, to loan after their reserve was reduced to a fifth of the requirements of that law, and, by the device of loan certificates for the settlements among themselves, made arrangements for devoting their legal-tender notes to the last dollar to this purpose. It was, in fact, a suspension of the banking law precisely similar in nature to the suspension of the Act of 1844 in England, except that the strain, which was met there by the rise in the rate of interest with

only a nominal infraction of the Act, required in this country a considerable supply of notes beyond that contemplated by the law. Our aim will be to show that in a combination of the two expedients is to be sought the true basis for dealing with panics. The New York banks, in the matter of loaning freely, came to the same conclusion which Mr. Bagehot shows the Bank of England to have arrived at after a series of experiments. It remains to consider the subject of a rise in the rate of interest.

This method proceeds upon the theory of contraction. It is assumed that inflation and consequent ease of money have produced, first, a rise of prices, making the country a good one to sell in and a bad one to buy in, causing an excess of imports as compared with exports, in other words, an unfavorable course of trade; second, a similar movement in securities, advancing the prices of those at home and attracting others from abroad; and, third, the withdrawal of foreign capital, which no longer finds attraction in loans and discounts, and also of home capital, which for the same reason seeks employment abroad. When these causes have at length caused a drain of gold in excess of current import and export, and have thereby reduced (we are speaking of England) the supply of notes, a rise of interest produces exactly the reverse effects. First, it brings home domestic capital, and attracts foreign capital to be employed in loans; secondly, a further advance, by depressing securities, attracts purchasers from abroad, or sends off certain classes to be sold in foreign markets; thirdly, if carried to a sufficient point it reduces the prices of all products in the home markets and a reversal of the course of foreign trade: all of which effects together produce a renewed accumulation of gold, a consequent increased supply of notes, and ease in the money market. And besides these indirect and somewhat remote effects of the advance in the rate of interest, it has one other effect which is immediate and direct. In Mr. Bagehot's words, "it will operate as a heavy fine on unreasonable timidity, and will prevent the greatest number of applications by persons who do not require assistance. The rate should be raised early in the panic, so that the fine may be paid early; that no one may borrow out of idle precaution without paying well for it; that the banking reserve may be protected as far as possible."

But with all the advantages of changing the rate of interest as a financial measure, there are some considerations which indicate that it has not yet been fully tested, and leave room for doubt whether it is ultimately to prove an efficient instrument for steadying the mass of deposit currency, which has become such an important problem in modern finance. We believe the great financial cycles to be far more mechanical than Mr. Bagehot seems to suppose. He regards panics or crises as the result of sudden accidents, prominent among which he places deficient harvests, and proceeds to explain how the effect extends to other branches of industry, so that there are "good times" and "bad times" when nearly everybody is prosperous or else depressed. While we admit that such events determine the *times* of commercial crises so that the regular periodicity of the latter cannot be counted upon, we believe them to be the result of a sequence of causes as directly as the seed follows from the bud, the flower, and the fruit. Starting from a period of quietude or stagnation, the great money-lenders, and notably the banks, who have the peculiarity also of creating the money they lend, begin to push out their loans on every side. The ease of money thus resulting, after a greater or less conflict with inertia, gives a start to prices and activity to trade. This, as is well known, is an accelerating process, which, passing through the phases of excitement and speculation, results in inflated prices, adverse foreign trade, a drain of gold, and contraction of notes; the foundation being thus withdrawn, the superstructure comes down with a crash; the whole process, after an interval of stagnation, commencing again. The best illustration of this course of events is to be found in the returns of the New York clearing-house, which have fortunately been preserved for twenty years past. They are for the years ending

	Millions.		Millions.
Oct. 1, 1854	$ 5,750	Oct. 1, 1864	$ 24,097
" 1855	5,363	" 1865	26,032
" 1856	6,906	" 1866	28,717
" 1857	8,333	" 1867	28,675
" 1858	4,756	" 1868	28,484
" 1859	6,448	" 1869	38,527
" 1860	7,231	" 1870	27,804
" 1861	5,915	" 1871	29,300
" 1862	6,871	" 1872	32,637
" 1863	14,868	" 1873	35,455

Note how the figures increase up to the crisis of 1857, how in the year following they fall nearly one half, but again increase up to the panic in the autumn of 1860; falling off again in the depressed year preceding the war, but receiving a tremendous impulse with the suspension of specie payments and the issue of legal-tender notes. The subsequent figures speak volumes as to the real depreciation of our currency and the real difficulty of a return to specie payments, but that is apart from our immediate purpose.

The returns of the London clearing-house have been preserved only since 1867, but they tell the story very distinctly on one side of the account. They are for the years ending

	Millions.		Millions.
April 30, 1868	£3,257	April 30, 1871	£4,018
" 1869	3,534	" 1872	5,359
" 1870	3,720	" 1873	6,003
		" 1874	5,994

The figures for the year succeeding the next commercial panic in England will be of very great interest.

The real instrument for the correction of overinflation and speculation is the panic, with its contraction of currency or of the rapidity of circulation with a fall of prices. The three suspensions of the Act of 1844 calmed the public frenzy in its final agony, but they did not operate the correction of trade. That work was already done. In like manner the changes of interest, though they steady the inflating process and enable it to go on with a smaller basis of reserve, have not as yet succeeded in obviating the necessity of a crisis. In connection with the above statement of the clearing-house returns, a table of the changes in the Bank of England rate of interest since 1867 will not be uninstructive.

	1867.		1868.		1869.		1870.		1871.		1872.		1873.		1874.	
	Day.	Rate.	Day.	Rate.	Day.	Rate.	Day.	Rate.	Day.	Rate.	Day.	Rate.	Day.	Rate.	Day.	Rate.
Jan.	..	..	..	..	..	..	..	..	..	..	..	..	8 22 29	4½ 4 3½	7 14	4 3½
Feb.	..	..	..	..	..	..	..	..	21	3	..	..	..	..	..	..
Mar.	..	..	..	..	5	4	..	..	..	..	..	..	26	4	..	..
Apr.	..	..	..	..	..	..	..	..	12	2½	3 10	3½ 4	..	..	29	4
May	..	..	..	..	5	4½	..	..	..	..	8 27	5 4	7 10 17	4½ 5 6	27	3½
June	..	..	..	..	9 23	4 3½	..	..	14	2¼	12 19	3½ 3	4 12	7 6	3 17	3 2½
July	..	..	..	..	21	3	20* 23 27	3½ 4 5	12	2	17	3½	9 16 23 30	5 4½ 4 3½	.. 29	.. 3
Aug.	..	..	..	..	18	2½	3 10 17 24 31	6 5½ 4½ 4 3½	..	..	..	..	20	3	.. 5 19 26	.. 4 3½ 3
Sept.	..	..	..	..	..	..	14 28	3 2½	20 27	3 4	18 25	4 4½	24 29	4 5	..	..
Oct.	..	..	..	..	..	..	..	..	7	5	2 9	5 6	14 15	6 7	..	..
Nov.	9	2	18	2½	3	3	..	..	15 29	4 3½	9 27	7 6	1 7 19 26	8 9 8 6	..	..
Dec.	..	..	2	3	..	..	..	..	13	3	11	5	3 10	5 4½	..	..

During the years 1867 and 1868 there appears a dreary monotony of low rates. In 1869 there is increasing activity, the rate having once touched four and a half, but business is still so sluggish that the low rates continue through 1870; even the Franco-Prussian war producing only a temporary disturbance. After that year the pace begins to quicken. With frequent fluctuations the rate touches five per cent in the autumn of 1871 and again in the spring of 1872. With still greater fluctuations it touches seven per cent in the autumn of 1872 and the spring of 1873. At length in the autumn of 1873 it reaches nine per cent, the highest ever reached without the accompaniment of violent panic. But there was no panic,

* Outbreak of the Franco-German war.

although the Bank of England reserve had fallen to barely seven per cent on the deposits of the London banks, the reason apparently being that the public have become so convinced that the government will in case of necessity suspend the Act of 1844, that they decline to be frightened. Comparing this table with the clearing-house returns, and with the known facts as to the markets which may be gathered from the London papers of the last few years, we can hardly resist the evidence of a great and rising wave of inflation and speculation which must culminate sooner or later in panic and revulsion. The clearing-house returns show no check given as yet. Money is as easy and prices about as high as at any time previous, and new foreign loans placed on the London market have met with nearly undiminished favor. It is hardly to be expected that the bank will put the rate to what we should call high figures, say fifteen, eighteen, and twenty-four per cent, before the reserve gets low enough to bring on the usual panic and suspension of the Act, but we should very much like, in the interest of science as well as the public welfare, to see a state of things in which the reserves should be sufficient to preclude the possibility of panic, and should be maintained at that point by a resolute and persistent advance of rate to any point that might be necessary, coupled with liberal loans upon all good security.* Mr. Bagehot says that it is hopeless to expect a many reserve system in England, and as it seems equally hopeless to expect a maintenance of reserves by a movable rate of interest here, the solution of the problem must probably be left to another generation, the present one getting on with the rough surgery of panics and with chronic suspensions of law. While, however, we agree with Mr. Bagehot in condemning the "hard and fast line" of our many

* From some appearances, such as the falling-off in the clearing-house returns for the last year, the decline last spring in some of the great English staples, and the continued ease of money with the low rate of interest, it might be argued that the nine-per-cent rate of last fall had corrected inflation without panic; *per contra,* the clearing-house returns, which indeed fell off but slightly, have been gaining again, prices have partially recovered, and the condition of the Bank of England is such as to make the ease of money very precarious. We are inclined to look upon this year as one merely of slack water at high tide, and that the real ebb has yet to take place.

reserve system, that is, which allows the banks to discount at a fixed rate of interest up to a certain point and then forbids discounts entirely, we do not admit that it is a necessary feature of such a system. For instance, suppose that, beginning at the average reserve of thirty per cent, the clearing-house should announce that no bank having less than that percentage would make any loans below a certain rate of interest, which rate of interest would be advanced when the average fell to twenty-nine per cent, and so on. It would be a rule for which the banks would themselves feel no repugnance; and if made a matter of law, with penalties, it would at least not be worse than the present requirement which there is no pretence of enforcing.

After the above was written there appeared in the *Economist* an article, in Mr. Bagehot's marked style, peculiarly apropos to our immediate topic. Its purpose was, after demonstrating the recurrence of financial cycles, to consider what stage of a new cycle the money market is entering upon :—

"But it will be said, What do you mean by perturbing causes? What is it they perturb? What is the usual and constant cause? We answer, that this cause is the *ratio of the savings of the country to its accredited investments.* In a depressed period these savings are more than can be employed in the modes of investment then understood. The beginning of the cycle is a depression in commerce that lasts for a considerable time, no matter how it is caused. Experience shows that in this country such depressions are only temporary; after a short interval commerce begins to revive. In a declining country, where depression was the ordinary condition of trade, and prosperity the exception, all the phenomena with which we are dealing would be reversed. And when trade once begins to augment, the ratio between the savings of the country and its investments very soon tends to be altered. Much more trade means many more 'bills'; many more 'bills' mean a great increase of demand in the London money market.

"This is the first stage of the cycle; and the next question is, Why should not this small rise be the only one, and the moderate advance in the value of money be permanent? The answer is, that the commerce of this country when once started out of depression augments faster than the savings. The prosperity of each trade acts as a stimulus to every other trade. This is the second stage of the

cycle, and we shall be again asked what will bring it to an end. The reply is, that a trade strained to its maximum is a delicate trade, and that any considerable accident is sure to diminish it. Some circumstance or other is sure to happen to lessen the full productiveness of some considerable trade; if this circumstance affects many trades alike, the effect is all the greater, and the course of universal prosperity is broken. This brings us to the end of the cycle. We have reached a period of depression similar to that from which we began, and from that period a similar upward course with similar results is sure to commence again."

This extract illustrates perfectly the point on which we differ from Mr. Bagehot. We believe that the vast mass of deposit currency created by the banks, by means of loans, acts as a stimulus to trade; that by greatly increased rapidity of circulation it urges that trade to inflation and speculation; and that this process results in a drain on the reserve of gold, a contraction of the note currency, and, whatever may be the accident which precipitates it, in a crisis, which the banks, having done much to cause, do still more, by keeping no cash reserve, to augment. Mr. Bagehot, on the other hand, considers that the banks simply receive and employ the savings of the community; that these wait upon the course of trade, which, receiving its impulse only from the progressive spirit of the people, becomes more and more active, and continues to absorb the savings, and that by and by some untoward accident, as a foreign war or a bad harvest, affects one great trade, and the paralysis extending to others, the whole is thrown back to the period of depression. Our view implies that the banks are endowed with vast privileges to their own great profit, and with extreme liability to abuse to the great detriment of the public; and that the government is especially bound to protect the public from such abuse; in short, that deposit currency is just as much a subject of government regulation as note currency; and that in such regulation is to be found the effective amendment of the Act of 1844. According to Mr. Bagehot's view, the banks are merely conducting a trade like any other; a trade which they carry on with great conservatism and success, in many respects with benefit, certainly not with detriment, to the public; and they are therefore entitled to freedom

from government interference. We leave to our readers to decide which view is most logical, and to time to show which is most practical as well as philosophical.

Mr. Bagehot submits in the same article some striking figures in support of the facts as to which we both agree. They show the average rate of interest of the Bank of England for each year since 1844, and we only regret that they cannot be compared with the transactions of the clearing-house during the whole time. The separating lines mark the crises in which the cycles end:—

1844	$2\frac{1}{2}$
1845	3
1846	$3\frac{1}{4}$
1847	5
1848	$3\frac{3}{4}$
1849	3
1850	$2\frac{1}{2}$
1851	3
1852	2
1853	$3\frac{1}{2}$
1854	5
1855	$4\frac{3}{4}$
1856	$5\frac{3}{4}$
1857	$6\frac{3}{4}$
1858	$3\frac{1}{4}$
1859	$2\frac{3}{4}$
1860	$4\frac{1}{4}$
1861	$5\frac{1}{4}$
1862	$2\frac{1}{2}$
1863	$4\frac{1}{2}$
1864	$7\frac{1}{2}$
1865	$4\frac{3}{4}$
1866	7
1867	$2\frac{1}{2}$
1868	2
1869	$3\frac{1}{4}$
1870	3
1871	3
1872	$4\frac{1}{4}$
1873	$4\frac{4}{5}$

Two observations may be made upon this table, especially in connection with the details of the changes in the last period given in our previous table: that as the superstructure of deposit currency has grown up from twenty-three millions to one hundred and twenty millions, the fluctuations of interest have become more frequent and violent, in other words, the whole fabric "lurches" much more heavily; and that while the average reserve has in like manner become less in proportion to the aggregate of liabilities dependent upon it, a decided and sharp rise in the rate of interest has been an efficient instrument in staving off crises. Whether, with a really adequate reserve, it will prove to be equal to the task of averting them altogether, and of making the process of recovery as gradual as that of inflation, distributing the losses like the profits with tolerable fairness over the community, instead of descending like an avalanche upon the unfortunates who happen at a particular moment to be exposed,—this is the problem to be settled by the experiments of the future.

We are well aware that we shall have to encounter the inevitable *cui bono.* What practical lessons for us are to be drawn from all this? First and foremost among these is the

necessity of continuous administration. The discussion which commenced with the Bullion Committee of 1810 was continued through the resumption in 1821, the crisis of 1825, and that of 1837, narrowing all the time closer and closer upon definite points, until under the firm leadership of Sir Robert Peel it culminated in the Act of 1844. Since then the operation of that Act has been keenly watched, and the debates getting steadily nearer to the real issue. Such ideas as Mr. Bagehot's book advances would have been laughed at in 1844. But now there has been a report, which if not true shows the state of the public mind, that Mr. Gladstone intended, if his administration had continued, to take up the subject of the joint-stock banks and their reserves. What, on the other hand, is the state of things with us? There are nearly as many schemes for resuming specie payments as there are members of Congress. None of them are thoroughly based upon the experience of the past, it being the fashion to say that the laws of currency which are established in Europe do not apply here. None of them propose any definite end to be attained, confining themselves to the general question of contraction as an instrument. Not one of them has the slightest chance of having a fair trial, because the decision on this point rests with the Committee of Ways and Means and that on Banking, who, so far as they are not under private influence, and as they are not responsible for the working of whatever measures are passed, seem to be waiting for public opinion; as if the public knew anything about the matter! The managers of the Coast Survey might as well ask the public to direct their operations. As to the force of public opinion, we heartily subscribe to the following words of the *London Spectator:* "Popular electoral government has the power, without calling out troops or using menaces, to rush over the strongest single class in the nation, and to do this sometimes, as in the Corn Law case, when that class is backed by allies controlling nearly half the kingdom." But just as the expansive force of steam is utterly useless unless applied through a piston-rod, so public opinion is an empty name unless wielded by definite leaders. The public opinion of the nation as a whole has no voice in Congress. The Secretary of the Treasury is the nominally re-

sponsible financial officer of the government, and it is just because with that responsibility he has no real power that we see that office, with the increasing difficulty of the finances, falling into constantly weaker hands. We believe that the first step towards specie payments will be to place the Secretary of the Treasury in Congress, and call upon him for a comprehensive and detailed plan for the management of the finances in all the parts; and to expose this plan to the crucial test of thorough debate, with such sweeping away of weak and ignorant men, and vigorous projection of strong and skilful ones, as would certainly follow. The man who could ultimately hold the place would have to know all that there is to be known as to the past history or present effects of currency, and to be able so to apply his knowledge, and to foresee the consequences of his plans, as to be ready to encounter the most searching criticism. And when the public became convinced that the man had appeared, which they would be, not from any understanding of his plans, but from his bearing in the conflict, and from the rallying around him of other most trusted public men, they would lend him a force which would make our last quotation a practical reality.

There can be little doubt that the most powerful obstacle to specie payments will be found in the national banks. These institutions have upwards of nine hundred millions of loans, and contraction to a specie basis would reduce the value of these, at a low estimate, by twenty per cent on the average. They naturally do not regard a process like this with much favor, and it is notorious that no legislation has a chance in Congress which threatens seriously the interests of the banks. They are under so little control that Congress cannot even force them to incur the slight expense of keeping their currency in decent condition, notwithstanding that the government is ready to furnish new notes without extra charge. The Comptroller of the Currency presents about the figure of a six-years-old child driving a runaway horse. It will need the whole power of a national champion, backed by the concentrated force of public opinion, to induce these institutions to set their houses in order.

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